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SUPREME COURT OF THE UNITED STATES

October Term, 1959

No. 834

OLDHAM CLARKE, Trustee for Debtor,
Frank Fehr Brewing Co., - - - - Petitioner,

versus

UNITED STATES OF AMERICA, - Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

AND

BRIEF FOR THE PETITIONER

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Supreme Court of the United States

October Term, 1959

No.

OLDHAM CLARKE, Trustee for Debtor, Frank Fehr Brewing Co., - - *Petitioner,*

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OPINION BELOW

The opinion of the United States District Court for the Western District of Kentucky (Record 29a) is reported in 160 F. Supp. 631. The Court of Appeals for the Sixth Circuit affirmed the District Court without opinion.

JURISDICTION

The order of the Court of Appeals was entered on January 15, 1960 (Record, following 217b). Jurisdiction of this Court is invoked under 28 USC 1254(1).

QUESTION PRESENTED

Does the taking of an unauthorized deduction on a corporate income tax return constitute fraud with intent to evade tax and thus avoid the three year limitation on the assessment of additional taxes and penalties?

In this case a claim by the United States against the debtor corporation for additional income taxes for the years 1948 through 1952 is barred by the federal statute of limitations because not assessed within three years after the returns were filed for said years, unless for these years the debtor filed "false or fraudulent returns with the intent to evade tax" (26 USC 6501).

There is no substantial evidence in this case to justify the conclusion that the returns in question were "false or fraudulent with the intent to evade tax", and there is no finding of fact sufficient to support such conclusion.

The District Court held that, "The fraud lay in the representation to the Government that these amounts constituted office travel, or advertising expenses, were therefore legitimate deductions, when in truth and in fact they were not" (R. 36a).

The petitioner contends that this holding is erroneous and contrary to law in that such construction nullifies the statute of limitations.

STATUTES INVOLVED

26 USC 6501 (Internal Revenue Code of 1939 Sections 275 and 276) provides as follows:

> "Section 6501. *Limitations on Assessment and Collection.*
>
> (a) *General rule.*—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, within 3 years after such tax became due, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.
>
> * * * * *
>
> (c) *Exception.*—
>
> (1) *False return.*—In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time."

26 USC 7454 (Internal Revenue Code of 1939 Section 1112) provides as follows:

> "7454. *Burden of Proof in Fraud and Transferee Cases.*
>
> "(a). *Fraud.*—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary or his delegate. * * *"

STATEMENT

The Frank Fehr Brewing Co., a Delaware corporation, with its brewery and offices at Louisville, Kentucky, on August 13, 1957 filed a voluntary petition for corporate reorganization under the provisions of Chapter X of the Bankruptcy Act, and the petitioner, Oldham Clarke, was appointed Trustee.

On August 29, 1957 the respondent, United States of America, filed a CLAIM in the reorganization proceedings for $367,515.68 as additional income taxes, interest and penalties for the years 1948 to 1952 inclusive, and for the year 1954. This claim involves principally (a) officers' expenditures, (b) capital expenditures and (c) the salary paid Colonel Frank Fehr as president of the debtor (R. 34a).

The Trustee filed OBJECTIONS AND EXCEPTIONS to the tax claims, in which he denied the claims, and pleaded that the claims for additional taxes for the years 1948 to 1952 inclusive are barred by the federal statute of limitations (26 USC 6501) because not assessed within three years after the returns were filed for said years.

The United States filed a REPLY which pleaded that the returns for said years were "false and fraudulent with the intent to evade tax" and within the exception contained in the statute, on the alleged ground that each of the returns reported, "as legitimate and necessary business expenses sums of money paid to or on behalf of Frank Fehr and Fehr Kremer, officers of the debtor, in the amounts tabulated in the table

attached hereto, whereas in truth and in fact said amounts were used and expended by said officers individually and on their own behalf and had no connection with the legitimate and necessary business expenses of the Debtor."

By a PRE-TRIAL ORDER the District Court directed that a separate trial be had on the issue raised by the reply to the defense of the statute of limitations and that the United States had the burden of proving that any of the returns for the years 1948 to 1952 inclusive was a "false or fraudulent return with the intent to evade tax."

After an extended trial before the court without a jury on the question of limitations alone, the District Judge handed down a MEMORANDUM OPINION (160 F. Supp. 631) including findings of fact and conclusions of law to the effect that the returns were fraudulent (R. 29a). Before any order or judgment was entered the parties, without waiving their position on the question of limitations, stipulated certain facts concerning officers' expenditures, capital expenditures, and as to the salary of Colonel Fehr (R. 39a), and the United States moved for a summary judgment (R. 43a). The court then entered a judgment (R. 51a) which reads in part as follows:

> "1. That the Trustee's plea of the statute of limitations is denied, and Trustee's request for additional findings of fact and conclusions of law is overruled.
>
> "2. That the claim of the United States for additional income taxes for the years 1948 to 1952

inclusive, and the year 1954, is allowed in the amount of $117,153.69 as a priority claim under 11 USC Section 104(4).

"3. That the claim of the United States for interest on the aforesaid tax deficiency is allowed as a priority claim in the amount of $39,543.44, which is interest at the legal rate up to August 13, 1957, the date the petition was filed under Chapter X of the Bankruptcy Act.

"4. That the claim of the United States for penalties on the aforesaid deficiency in income taxes in the amount of $68,261.61 is denied in its entirety."

The Trustee prosecuted an appeal from the first three paragraphs above quoted from the judgment of the District Court, and the Court of Appeals affirmed the judgment without opinion.

Attached to the Reply of the United States is U.S.A. Exhibit No. 1 (R. 212b) in which are listed some 80 odd items of expenditures which were taken as deductions over a period of seven years on the corporate tax returns but which were claimed by the United States to represent personal expenses of Mr. Fehr Kremer and Col. Frank Fehr, the two principal officers, having no connection with legitimate and necessary expenses of the corporation. During the course of the hearing a revised exhibit was filed (Exhibit No. 60) in which some 76 items were listed covering the period of seven years (R. 215b).

The Government's claim of fraud was based largely upon an examination of the corporate records by

A. Joseph Zimmerer, an Internal Revenue Agent, Field Audit Branch of the Treasury Service at Louisville, and upon testimony of the witness Arlie Chastain,

The items thus described fall generally into the following categories: automobile expense; local hotels; social clubs; personal employees; out of town hotels; Florida expenses; television set and trunk. It was conceded by the Government's counsel that Mr. Zimmerer had no independent knowledge of whether these items were business expenses or not. The classification of items was based on information received by him from three informers, who were former employees of the company.

Arlie Chastain was Controller of the corporation during all of the years in question and in charge of the corporate books and records. He had been discharged prior to the hearing; he was an informer, and, as such, was interested in any recovery (R. 74a). He also admitted that in many instances he had given contrary evidence under oath in another proceeding (R. 53a). He testified that the questioned items were charged to expense because the officers concerned (Colonel Fehr or Fehr Kremer) told him to do so; that drafts on the company drawn by Colonel Fehr were charged as "office travel"; that both Colonel Fehr and Fehr Kremer signed petty cash vouchers; that these officers did not always substantiate the items. He handled the items in this manner in accordance with previous instructions on similar bills in the past but admits that he did not receive these instructions in every instance. He knew these officers took vacations and assumed the

expenses incurred were of a personal nature although he was not personally present. He claimed to know that sometimes the company automobiles were used for personal purposes; that some of the company employees were used for the personal purposes of the officers. He testified that he considered all of these items to be irregular on the corporate books (R. 25b) and that no adjustments were made on the tax returns (R. 48b).

Mr. Fehr Kremer, who was the corporation's chief executive officer at the times under review, and when it filed its reorganization petition, and Colonel Fehr, each testified that they not only intended to do so, but that in their opinion they did, in each year, reimburse the corporation for all items expended on their behalf by the corporation which were not proper corporate expenses (R. 62a, 56a, 56b and 135b).

The officers who signed the returns (R. 35a), the accountants who prepared the returns (R. 71a), and the directors of the corporation (R. 36a) all were of the opinion that the expense items were proper expenditures for the corporation and therefore deductible.

ARGUMENT

The District Court and the Court of Appeals have erroneously decided an important question of federal law and of the administration of the revenue laws, which have not been, but should be, settled by this Court. Rule 19(b).

There is no contention that the claim of fraud is based upon the conduct of the corporation in keeping a double set of books; in making false entries or alterations; in making false invoices or documents; in the destruction of books or records; in the concealment of assets or covering up sources of income or of failing to keep usual and customary records. The above actions by a taxpayer were described by this Court as comprising the most usual and common circumstances which possibly justify the inference of a fraudulent intent. *Spies* v. *U. S.*, 317 U. S. 492, 63 S. Ct. 364, 87 L. Ed. 418. While the above statement was made in a criminal case and while there may be a difference in the character of proof required between a criminal and a civil case, that general statement is equally applicable to a charge of fraud in a civil case.

The present petition does not present any questions with respect to the tax returns of the individuals concerned. Whether the tax returns of the two officers of the corporation contained understatements of income is not now before the Court. The sole question is whether the tax returns of the corporation were fraudulent.

I.

There Is No Presumption of Fraud Merely Because a Return Incorrectly Contains Unauthorized Deductions

The question as to when and under what circumstances a corporate income tax return shall be deemed fraudulent is one which remains largely unexplored by the courts. Most of the decided cases have involved the returns of individuals.

The problem, as relates to corporate returns, involves a reconciliation of proper corporate action on the one hand, with the technical requirements of the Internal Revenue Code on the other. Proper and legitimate corporate action is one thing. The determination of whether such action involves an expense which is deductible as being "ordinary and necessary" within the technical meaning of the Code is quite another.

From the corporate point of view it has never been suggested that it was improper in any sense for the corporation to furnish an automobile for its executives, or to pay their club dues, or travel or entertainment expense or even to give them expense paid vacations. But whether, and to what extent, such items may be transferred into the tax returns as deductible expense items requires an intimate and exhaustive knowledge of court decisions, regulations and interpretations, with little or no guidance even with such information.

This court itself has characterized this problem as "a field necessarily beset by innumerable complexities." *Commissioner of Internal Revenue* v. *Hein-*

inger, 320 U. S. 467, 475, 88 L. Ed. 171, 177, and this Court has further said, with reference to the words "ordinary and necessary", in *Welch* v. *Helvering*, 290 U. S. 111, 114, 78 L. Ed. 212, 215, that:

> "Here, indeed, as so often in other branches of the law, the decisive distinctions are those of degree and not of kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle."

For these reasons the courts have uniformly held that the mere fact that a return is incorrect, or contains unauthorized deductions, creates no presumption that the return is fraudulent. *Davis* v. *Commissioner*, 10 Cir., 184 F. 2d 86, 22 ALR 2d 967; *Hawkins* v. *Commissioner*, 6 Cir., 234 F. 2d 359.

As said in *Davis* v. *Commissioner, supra:*

> "Fraud implies bad faith, intentional wrongdoing and a sinister motive. It is never imputed or presumed and the courts should not sustain findings of fraud upon circumstances which at the most create only suspicion."

In other words, for a corporate return to be held fraudulent more must be shown than that the return was incorrect. It must be shown that the corporate taxpayer was familiar with the tax law applicable to corporations and deliberately filed its return with the express intention of evading its taxes.

Nothing of this sort was shown in this case and no such finding was made by the District Court as will be later shown here.

II.

There Can Be No Inference of Fraud Where the Corporate Tax Returns Were Made by Certified Public Accountants

For the same reasons above stated, the courts have uniformly held that there can be no inference of fraud where the corporate returns are made by Certified Public Accountants. *Hatfried, Inc.* v. *Commissioner,* 3 Cir., 162 F. 2d 628; *Haywood Lumber and Mining Co.* v. *Commissioner,* 2 Cir., 178 F. 2d 769; *Davis* v. *Commissioner, supra; John P. Winn,* 12 T.C.M. 886; *U. S.* v. *Pechenik,* 3 Cir., 236 F. 2d 844, and many other cases that might be cited.

The complexities of the income tax law are so great that practically all corporations and a great many individuals find it necessary to employ accountants to make out their returns. In the present case the tax returns for all of the years in question were made by the firm of Escott, Grogan & Co., a highly reputable firm of accountants in the city of Louisville (R. 32a). That firm had done the auditing and tax work for the corporation since its organization.

Neither of the officers concerned nor Mr. Chastain, the Controller, had anything to do with making out the tax returns except to sign them.

Tax returns are required to be made out in the precise manner indicated by various tax forms. In the

process of making the annual audits and preparing the tax returns all of the books and records of the corporation were made available to the accountants (R. 128b). Substantial items were customarily discussed with the management and the auditors always made such reasonable investigation as the situation required. Any item which was considered by the accountants to be nondeductible for income tax purposes would be eliminated (R. 102b).

The corporate records contained evidence of all the expense items now in question, although as to some of them there was a lack of supporting data (Comment by Court, R. 136b). In making the annual audits and in preparing and filing the tax returns, the accountants used their own independent judgment as to whether the questioned items should be taken as deductions from gross income in determining net taxable income. Mr. Escott testified that the question of what expenses are "necessary and ordinary" frequently becomes a matter of opinion and of company policy and of the good faith judgment of the accountant as to how they should be handled (R. 132b). His firm took the responsibility in making and filing the tax returns and it is not a material question in this case as to whether their decisions were erroneous or not.

In view of the necessary practice of employing accountants in preparing tax returns it has been uniformly held that there can be no fraud where the returns are made in this manner and all records are made available to the accountants.

III.

There Is a Presumption That the Returns Were Correct After They Were First Examined by Revenue Agents.

Prior to the examination of the returns which were the basis of the Government's claim of fraud in the reorganization proceedings, each of the returns had been examined by revenue agents. The 1948 return was examined in 1950 and other returns were examined in 1951 and 1953 (R. 13a, 14a). In each of these examinations some small deficiency in tax was found but no question was raised as to the expense items involved in the present action.

The testimony shows that at the time of these several examinations the revenue agents had full access to the company records and with full opportunity for discussion of the returns with the officers of the corporation and with the company's accountants. In the absence of evidence to the contrary, it must be assumed that these revenue agents properly performed their functions, that they were aware of these expense items and passed them as being proper deductions.

It is common knowledge that only within the past year has the Internal Revenue Service extensively publicized its Rules and Regulations with respect to travel and entertainment expense and kindred items.

At the time the returns in question were filed, it was the common practice of many corporations to make literal allowance for travel and entertainment expense and to report these expenses as deductible items

on their tax returns without being seriously questioned. Such liberal treatment may be evidenced by a great number of cases, among which might be cited *Cohan* v. *Commissioner*, 2 Cir., 39 F. 2d 540; *Ralph E. Duncan*, 30 T.C. 386; *Gaines, Inc.*, 10 T.C.M. 284; *Faitoute Iron & Steel Co.*, 11 B.T.A. 818, and also many more recent cases in which might be included *Silverman* v. *Commissioner*, 8 Cir., 253 F. 2d 849; *Finley* v. *Commissioner*, 10 Cir., 255 F. 2d 128; *Williams* v. *U. S.*, 5 Cir., 245 F. 2d 559.

These cases are of importance primarily because in none of them was any question of fraud even suggested. The reason for this is quite plain. The dividing line between what expenses for travel, entertainment, advertising and similar corporate purposes are proper deductions, and which are not, has never been adequately defined by law, the regulations or the decisions of the courts as we have previously pointed out. Here again the distinction between corporate action as such and technical tax returns becomes of prime importance as does the distinction between corporate returns and returns of individuals. And again the importance and, in fact, the necessity of the employment of reputable accountants upon whom the corporation can rely to file correct returns, becomes most material.

IV.

The Conclusion that the Returns Were Fraudulent Is Not Supported by the Evidence or the Findings of the District Court

The Court of Appeals did not write an opinion in the case but merely entered an order that the judgment of the District Court be affirmed on the opinion of the District Judge reported in 160 F. Supp. 636. Consequently, it is necessary to go back to the opinion and findings of fact of the District Court. The basis of the holding of fraud is the finding (R. 36a) that:

> "The fraud lay in the representation to the Government that these amounts constituted office, travel, or advertising expenses and were, therefore, legitimate deductions when, in truth and in fact, they were not."

This is nothing more than a conclusion that an incorrect return is always fraudulent. If this principle is correct, any error in a return is a misrepresentation and, consequently, fraudulent. This conclusion was clearly erroneous.

The Court did find that in many instances there was a lack of supporting data for the various items and that in many instances there was no recorded authorization for the expenditure (R. 33a to 35a).

On the other hand, there was a finding that there was a belief that these were legitimate corporate expenses and that they were approved by the Board of Directors (R. 35a, 36a).

There was no finding that these items were known to the officers of the corporation to be nondeductible

items or that they should have had such knowledge. In the absence of a finding of bad faith or intentional wrongdoing or in the absence of finding facts from which such intention might clearly be presumed, it was error to hold the returns fraudulent.

CONCLUSION

It is earnestly insisted not only that the decision below is erroneous but that it establishes a principle which nullifies the statute of limitations on the assessment of additional income taxes and makes it impossible for any taxpayer to be secure from the threat of additional income taxes being imposed for years long past. It, in effect, means that there is no limitation at all on the assessment and collection of income taxes, because if the decision below is correct, any incorrect return is fraudulent, and therefore always open to examination. Manifestly Congress desired to place a limitation on the time for such assessments and we urge the Court to construe the statute in such a way as to effectuate this intent.

A writ of certiorari should be granted.

Respectfully submitted,

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v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 834

OLDHAM CLARKE, TRUSTEE FOR DEBTOR, FRANK FEHR BREWING CO., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (R. 29a–38a [1]) is reported at 160 F. Supp. 631. The *per curiam* opinion of the court of appeals is reported at 274 F. 2d 824.

JURISDICTION

The judgment of the court of appeals was entered on January 15, 1960. The petition for a writ of certiorari was filed on April 4, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

[1] "R." refers to the appendix to the petitioner's brief in the Sixth Circuit. "Supp. R." refers to the separate appendix to the Government's brief in the Sixth Circuit.

QUESTION PRESENTED

Whether the two courts below were correct in finding that the income tax returns of the taxpayer corporation for the years 1948 through 1952 were fraudulent and therefore that the claim of the United States for delinquent taxes and interest is not barred by the statute of limitations.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * * *

(26 U.S.C. (1952 ed.) 275)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * * *

(26 U.S.C. (1952 ed.) 276)

STATEMENT

The Frank Fehr Brewing Company, the taxpayer, filed a voluntary petition for a corporate reorganiza-

tion under Chapter X of the Bankruptcy Act, c. 541, 30 Stat. 544, as amended. The United States filed a claim—pursuant to an order in the bankruptcy court requiring all creditors of the Company to file their claims—for additional federal corporate income taxes and interest assessed against the taxpayer for the years 1948 through 1952. After a three-day trial, at which eleven witnesses testified, the district court made the following findings of fact:

Colonel Frank Fehr was president of the taxpayer corporation during the years in question and Fehr Kremer, his nephew, was executive vice-president and director of sales and advertising. Fehr Kremer was also secretary until September 1950, when his son-in-law was elected secretary (R. 31a). These two men, who owned the majority of the common stock of the taxpayer, also served on the board of directors (R. 30a–31a) whose election they controlled through common stock ownership and the proxy mechanism (R. 7a–10a). Arlie Chastain, who was comptroller and chief bookkeeper for the corporation from 1935 to 1955, usually prepared and signed checks drawn on the bank accounts of the corporation during this period [2] (R. 31a).

The tax returns filed by the taxpayer for each of the tax years 1948 through 1952 contained deductions for personal expenses of Colonel Fehr, his wife, Fehr Kremer, and the latter's family, which were charged as business expenses, thereby reducing

[2] It was required that all checks be signed by any two of the following officers: Fehr, Kremer, Chastain, and Petot, the treasurer (R. 31a).

the net income reported in each of the years in question (R. 33a, 39a–43a). These deductions included in each of the tax years 1948 through 1952: checks issued by the taxpayer for the expenses of Colonel Fehr and his wife on trips to Florida; substantial payments made by the taxpayer to the Madrid Garage for the upkeep and storage of a Cadillac and a Lincoln automobile furnished to Colonel and Mrs. Fehr; and meals frequently eaten by Fehr Kremer at the Brown Hotel, alone or with members of his family. On each of Fehr Kremer's trips to Florida, extensive entertainment was charged to the taxpayer, even though these occasions were not attended by customers, prospective customers, or suppliers of material to the taxpayer (R. 33a–35a).

In addition, the following personal expenses were deducted in the individual tax years: in 1949, the expenses of Fehr Kremer, his wife, his daughter, and his son-in-law on a trip to Florida, and the cost of a television set for Colonel Fehr; in 1950, a substantial amount for the expenses of Fehr Kremer and his wife while spending a week at the Waldorf-Astoria Hotel in New York City;[3] in 1951, meals eaten by Colonel Fehr and his wife at the Brown Hotel, the salary of Paul Brooks, who accompanied them as chauffeur on their Florida trip, the

[3] This amount was ostensibly for expenses while attending a week-long convention in Philadelphia. In fact, Fehr Kremer attended the convention only one day and his wife did not attend at all. Their expenses at the Waldorf-Astoria were charged to the taxpayer as business, traveling, or advertising expenses (R. 34a).

salary of Reed Terrill, a personal servant to Colonel Fehr and Mrs. Fehr, and the cost of a rowing machine for Fehr Kremer which was installed in his home (R. 34a).

Mr. Kremer claimed that the above deductions were for legitimate expenses for advertising, creating good will, and otherwise furthering the interests of the taxpayer. Yet, both Colonel Fehr and Mr. Kremer knew that the taxpayer had not authorized these amounts to be expended for their personal benefit by any resolution or minutes in its records. Moreover, they also knew that the taxpayer's books, although showing the expenses in general terms, did not disclose their nature as for travel, entertainment, and other personal items as would be required under ordinary bookkeeping and auditing standards. Fehr and Kremer both had this knowledge when the tax returns were made, and the comptroller, Mr. Chastain, had this knowledge when he signed the tax returns for each of the years in question. Thus, while the directors of the company knew of the purposes of these expenditures, these purposes were not disclosed to the Government. Instead, it was represented to the Government that the expenditures were for office, travel, or advertising expenses and were therefore legitimate business expenses (R. 35a–36a).

The district court concluded that the Commissioner had carried the burden, which the court imposed upon him, of showing by clear and convincing evidence that the corporation's federal in-

come tax returns in each of the years 1948 through 1952 contained deductions which were not deductible as proper or necessary business expenses; that the corporate officers who signed and caused the returns to be filed knew that the deduction of substantial amounts claimed in the returns as office, traveling, and advertising expenses in fact represented expenditures for the personal benefit of Colonel Fehr, Fehr Kremer, and their families, and could not properly be considered as expenses of the corporation; that the deductions were fraudulently claimed; and that this fraud tolled the three-year statute of limitations (R. 35a, 37a–38a).

After the district court had ruled that the fraudulent returns had tolled the limitations statute, the parties filed a stipulation of facts (R. 39a–43a) in which the trustee conceded that for each of the years in dispute and for certain additional years the taxpayer had understated its net income by claiming improper deductions including the expenses of Colonel Fehr and Fehr Kremer. The total amount of expenses of Colonel Fehr and Fehr Kremer in the years 1948 through 1952, which it was stipulated should be disallowed, amounted to $115,932.44 (R. 39a–41a). On the motion of the United States for summary judgment, the district court allowed the claim for additional income taxes for the years 1948 to 1952 and the year 1954 in the amount of $117,153.69 and for interest to the date the reorganization petition was filed in the amount of $39,543.44 (R. 51a).

The court of appeals affirmed on the opinion of the district court. 274 F. 2d 824.

ARGUMENT

Section 276(a) of the 1939 Code, *supra*, p. 2, provides that "In the case of a false or fraudulent return with intent to evade tax * * * the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time." The only question presented to the courts below was whether the corporation's income tax returns for the years in issue were false or fraudulent with intent to evade tax. This question, depending on the facts in this particular record, presents no conflict of circuits or other ground warranting review by this Court. Moreover, the issue was resolved correctly by the two courts below.

1. Whether the corporation's income tax returns for the years in question were fraudulent presents a question of fact which must be determined from the entire evidence and surrounding circumstances. See *Bryan* v. *Commissioner*, 209 F. 2d 822 (C.A. 5), certiorari denied, 348 U.S. 912; *Rose* v. *Commissioner*, 188 F. 2d 355 (C.A. 9), certiorari denied, 342 U.S. 850; *Battjes* v. *United States*, 172 F. 2d 1, 5 (C.A. 6); *Eagle* v. *Commissioner*, 242 F. 2d 635 (C.A. 5); *Owens* v. *United States*, 197 F. 2d 450 (C.A. 8). The factual issue of fraud was carefully and thoroughly tried before the district court, which had ample opportunity during the three-day trial to see and hear the eleven witnesses who testified before it and to judge their credibility. An examination of the 211 pages of excerpts from the testimony of the trial, printed as the appendix to the Government's brief in the court of

appeals, demonstrates that the case was vigorously tried before an experienced district judge on behalf of the trustee of the taxpayer and all other parties. Moreover, throughout the trial Fehr Kremer, who has filed a brief *amicus curiae* here, was represented by counsel (Supp. R. 1b). The case was fully briefed and argued by both sides in the court of appeals.[4] After consideration of the record, the

[4] The opinion of the court of appeals, affirming the district court's order, which in turn confirmed a proposed plan of reorganization for the taxpayer, shows that while Fehr Kremer's former counsel withdrew after the judgment was entered in the district court in the present case, his present counsel commenced representation of him at least in the reorganization proceeding on April 24, 1959, long before briefs were filed by either side in the court of appeals in the present case. *In re Frank Fehr Brewing Co.*, 268 F. 2d 170, 175, certiorari denied, *sub nom. Kremer* v. *Clarke*, No. 317 Misc., this Term, petition for rehearing pending. Although Fehr Kremer's present counsel now criticize in their *amicus* brief the trustee's prosecution of the appeal from allowance of the tax claim, they filed no brief in the court of appeals. Moreover, the court of appeals in its decision in the reorganization proceeding stated with respect to the tax claim that "[t]he Trustee is vigorously contesting the liability, but the case is far from being finally decided," and pointed out that, even if the amount of the judgment here obtained by the United States was excluded, the total amount of claims prior to the common stockholders was reduced only to $1,174,626, which the corporation's assets were insufficient to pay. 268 F. 2d at 178.

denied, June 6, 1960

With the exception of the suggestion that the expenditures here involved might now be considered as additional compensation and hence properly deductible, all of the points which Fehr Kremer contends were omitted by the trustee in the court of appeals (*Amicus* Br. 12–19) were in fact raised by him in that court in written or oral argument. As to the new contention, the stipulation of facts makes clear that the expenditures here in question were not considered as compensation at the time they were made (R. 39a–43a).

briefs, and the argument of counsel, the court below affirmed on the opinion of the district court.

The district court's findings were certainly not clearly erroneous. See Rule 52(a) of the Federal Rules of Civil Procedure. The court of appeals found that they were sustained by the record. These concurrent findings are final in the absence of a very exceptional showing of error. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

2. Arlie Chastain, the comptroller of the taxpayer and hence the officer in charge of all accounting, testified in detail with respect to most of the questioned deductions (Supp. R. 4b–54b). Mr. Chastain was one of the officers who signed on behalf of the taxpayer corporation each of the returns for the years in question (R. 35a; Supp. R. 48b–49b). He testified that the facts which might have shown a connection between the expenditures in question and the taxpayer's business were kept within the knowledge of Colonel Fehr, Fehr Kremer, and himself and that Colonel Fehr and Fehr Kremer directed him to charge the disputed expenditures to business expense without substantiation (Supp. R. 4b–9b). Mr. Chastain further stated that at the time he signed the returns he knew that these expenses, being in fact expenditures for the personal benefit of Colonel Fehr, Fehr Kremer and their families, could not properly be considered as expenses of the corporation and that the records of the corporation were maintained in such a way that they did not reveal that the expenditures were actually made for the

personal purposes which are now admitted[5] (R. 35a; Supp. R. 5b–9b, 24b–25b).

C. R. Escott, a senior partner of the accounting firm of Escott, Grogan & Company, which audited the books and records of the taxpayer and prepared its tax returns, testified that he refused to close the audit with respect to the year 1952 until he received specific board approval of Colonel and Mrs. Fehr's Florida expenses in that year which amounted to $7,984.81. He requested board approval to relieve himself of responsibility as an independent accountant. Thereafter, Mr. Escott was notified that the board had expressly approved this item. The audit was closed and the returns filed accordingly. On subsequent investigation, however, he was unable to find any record of the approval in the minutes of the board of directors (Supp. R. 129b–131b). Mr. Escott further testified that, though he admonished the taxpayer's officers to provide substantiation or explanation of the amounts charged to expenses, no improvement was made (Supp. R. 132b, 141b).

John S. Petot, the treasurer and a director of taxpayer from 1936 through 1954, Leo Ross, a purchasing agent of taxpayer, and A. Joseph Zimmer, an audit agent of the Internal Revenue Service, all testified that the corporate books or records contained nothing explaining or substantiating the business purposes for which the expenses were claimed to have

[5] Fehr Kremer in his *amicus* brief (*Amicus* Br. 18) expresses disagreement with the courts below as to the weight to be given to Mr. Chastain's testimony. Such disagreement does not raise a question of law for this Court.

been incurred or even to reveal whether the expenditures in question were connected with the business of the taxpayer. Instead, the expenditures were simply charged to business expense (Supp. R. 108b, 118b–119b, 153b, 161b–162b, 165b, 170b–171b).

On the basis of this and other evidence, the district court found that the corporate officers who signed and caused the taxpayer's returns to be filed knew that the corporation had not authorized the expenses in question by any resolution or minutes in its records and knew that the records of the corporation did not show that the amounts were actually expended for the personal purposes which they now admit. The trial court found that Colonel Fehr and Fehr Kremer each had this knowledge when the tax returns were made and that Arlie Chastain had this knowledge when he signed the tax returns for each of the years in question[*] (R. 35a). In conclusion, the court found from the testimony that these corporate officers knew that the deduction of these substantial amounts claimed as business expenses in fact represented expenditures for the personal benefit of Colonel Fehr, Fehr Kremer, and their families and could not properly be considered as expenses of the corporation (R. 37a).

These actions and knowledge by the taxpayer's officers, coupled with their lengthy business experience and the recurrence of the deductions (R. 39a–

[*] Fehr Kremer co-signed with Mr. Chastain on the returns filed for the years 1948, 1950, 1951, and 1952. Mr. Petot, the treasurer, co-signed with Mr. Chastain on the return filed for the year 1949 (Supp. R. 48b–49b).

43a), are adequate to sustain the district court's further finding that the officers deliberately acted to conceal or misrepresent to the Government the actual facts in order to obtain unallowable deductions. The courts below were warranted in holding that such a deliberate suppression of vital facts constitutes a fraud which tolls the statute of limitations (R. 36a, 38a).

3. It is well settled that the fraudulent intent of a corporate officer signing a return is imputed to the corporation. *Crescent Manufacturing Co.* v. *Commissioner*, decided August 31, 1948 (1948 T.C. Memorandum Decisions, § 48,171), affirmed *per curiam*, 181 F. 2d 185 (C.A. 6); *United Mercantile Agencies* v. *Commissioner*, 23 T.C. 1105, affirmed on other issues *sub nom. Drybrough* v. *Commissioner*, 238 F. 2d 735 (C.A. 6); *Currier* v. *United States*, 166 F. 2d 346 (C.A. 1); *Auerbach Shoe Co.* v. *Commissioner*, 216 F. 2d 693 (C.A. 1); *United States* v. *Peelle Co.*, 137 F. Supp. 905 (E.D. N.Y.); *Saven Corp.* v. *Commissioner*, 45 B.T.A. 343, 355–356; *Summerill Tubing Co.* v. *Commissioner*, 36 B.T.A. 347, 351. Therefore, while Section 52(a) of the Internal Revenue Code of 1939 (26 U.S.C. (1952 ed.) 52) requires that the return be signed by two corporate officers, the circumstance that one of the authorized officers who signs a return does not know that it is false will not relieve the company from culpability, providing that the other officer had knowledge that the return is false. Thus, even if Fehr Kremer or Petot may be deemed to have acted without fraudulent intent, it is plain that the comptroller, Chastain, did have the knowledge that

the deductions were fraudulently claimed and the returns were false with the intent to evade tax.

4. Petitioner and the *amicus* (Pet. 14–15; *Amicus* Br. 16–17) refer to the fact that revenue agents examined the returns in question shortly after they were filed and did not object to the inaccuracy or incompleteness of the records. Surely, this is no defense to the claimed misrepresentations here. As Mr. Chastain testified, the agents who made the audits had only several days in which to do so and they merely looked at the books of the company and spot-checked the supporting vouchers (Supp. R. 53b–54b). The corporate books, however, failed to reflect the nature and purposes of the expenses in accordance with ordinary bookkeeping and auditing requirements (R. 35a) and there is nothing to show that any of the items in question appeared in the spot checks which were made. That the incomplete books, calculated to mislead the revenue agents, succeeded at first affords no defense to the taxpayer.

5. In signing the tax returns, the taxpayer's officers did not rely upon the advice of accountants that the deductions taken were proper. Instead, contrary to the contentions of the petitioner and *amicus* (Pet. 14–15; *Amicus* Br. 16–17), the accountants accepted the officers' representations that the deductions were business expenses despite lack of supporting papers (Supp. R. 126b, 128b-129b, 131b-132b, 134b, 140b-141b). Taxpayer cannot shift the responsibility for the deficiencies to accountants when all necessary information was not turned over to them and when the taxpayer, or its officers, did not seek the advice of

the accountants as to the propriety of the many personal expenditures for Mr. Kremer and Colonel Fehr which were charged to business expense. See *Lashells' Estate* v. *Commissioner,* 208 F. 2d 430, 436 (C.A. 6); *Bender* v. *Commissioner,* 256 F. 2d 771, 774 (C.A. 7); *Mauch* v. *Commissioner,* 35 B.T.A. 617, 627–628, affirmed, 113 F. 2d 555 (C.A. 3).

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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